In the Supreme Court of the United States

OCTOBER TERM, 1975

No. 75-375

WHITE FARM EQUIPMENT COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

The sole question presented by the petition is whether the value of shares of listed stock issued by the corporate parent of petitioner in exchange for the assets of another corporation should be determined by the mean stock exchange price on the valuation date, less an adjustment for blockage, as the court of appeals held, or by the formula price provided by the exchange agreement between the parties.

The pertinent facts are as follows: On October 31, 1960, White Motor Company (White Motor) acquired substantially all the assets of the farm equipment business of Oliver Corporation (Oliver), in exchange for 655,000 shares of White Motor stock plus $1,508,550 in cash and the assumption by White Motor of $281,396 of Oliver's liabilities (Pet. App. 12a).[1] The terms

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[1]"Pet. App." references are to the separately bound appendix to the petition in *White Farm Equipment Company* v. *Commissioner*, No. 75-375.

of the transaction were set out in an agreement executed October 3, 1960, which was approved by the shareholders of both corporations (Pet. App. 5a-7a). The agreement contained a formula, based on book value, for determining the amount of stock and cash to be given for the Oliver assets, and provided that the 655,000 shares of White Motor stock were to be accepted in exchange for the Oliver assets. The formula price assigned to the White Motor stock was $48.50 per share (Pet. App. 7a-8a). That figure represented the closing price of White Motor stock on the New York Stock Exchange on June 23, 1960, the date as of which, during the negotiations, an adjustment in assigned value was proposed (Pet. App. 4a). However, neither the written agreement nor any negotiations preceding the agreement indicated that the assigned value had any tax or accounting significance (Pet. App. 9a).

On its federal income tax returns for 1960, 1961, and 1962, petitioner computed depreciation deductions using a basis in the assets received from Oliver premised on a value of $48.50 per White Motor share, which was the price assigned to the shares in the agreement (Pet. App. 13a). However, on its 1960 federal income tax return, Oliver reported a loss on the disposition of the assets of its farm equipment business (Pet. App. 13a). In computing the amount of its loss realized on this exchange, Amerada Hess (successor by merger to Oliver) reported the fair market value of the White Motor shares received in the exchange at $36.3125 per share, which was the mean trading price on the New York Stock Exchange as of October 31, 1960, the date on which the exchange was consummated (Pet. App. 12a-13a).

In order to protect the revenue, the Commissioner took inconsistent positions with respect to the correct valuation of the White Motor shares exchanged and asserted deficien-

cies against both White Farm Equipment Company (Oliver's successor) and Amerada Hess (Pet. App. 13a). The cases were consolidated in both the Tax Court and the court of appeals, and the Commissioner has been essentially a stakeholder, whose primary concern has been to insure that the valuation of the shares should be treated consistently by both parties to the transaction (Pet. App. 13a-14a). However, on the merits, the Commissioner adopted the position of Amerada Hess, and argued in both the Tax Court and the court of appeals that the fair market value of the White Motor shares should be measured by the mean trading price on the New York Stock Exchange as of October 31, 1960, less a discount for blockage, to reflect the downward impact in the market price which would occur upon the sale of a large block of stock (Pet. App. 14a).

The Tax Court valued the White Motor shares at $48.50 per share, based on the formula price set forth in the agreement of the parties, in accordance with the position of petitioner White Farm Equipment Company (Pet. App. 67a). The court of appeals reversed, holding that the shares should be valued on the basis of the mean New York Stock Exchange market price as of the date the exchange was consummated, less a discount for blockage (Pet. App. 26a).[2]

1. In this case, petitioner acquired assets of another corporation in exchange for the stock of its parent, White Motors. Pursuant to the agreement, petitioner's parent issued 655,000 shares of its stock plus cash and assumed certain liabilities. The agreement provided a formula price for the White Motor stock of $48.50 per share, which was its market price on one day during the negotiations. However, on the day the exchange was consummated (October 31, 1960), the mean New York Stock Ex-

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[2]The Commissioner has filed a protective petition for a writ of certiorari (No. 75-558) against Amerada Hess Corporation, seeking review of the decision below only if the Court grants this petition.

change trading price of the stock was $36.3125 per share, which the court of appeals correctly held to be the relevant value for tax purposes for both parties to the transaction. Despite this independent evidence of the value of the shares as of the date the transaction was consummated, petitioner argues that since the agreement between it and Oliver assigned an original price of $48.50 to each share of White Motor stock, that amount should control for tax purposes.

The court of appeals (Pet. App. 16a) correctly applied the longstanding rule that where property to be valued consists of securities traded on a stock exchange, the average trading price furnishes the most accurate measure of fair market value. See *United States* v. *Cartwright*, 411 U.S. 546, 551; *Hazeltine Corp.* v. *Commissioner*, 89 F.2d 513, 519 (C.A. 3); *Richardson* v. *Commissioner*, 151 F.2d 102, 103 (C.A. 2), certiorari denied, 326 U.S. 796; *Andrews* v. *Commissioner*, 135 F.2d 314, 318 (C.A. 2), certiorari denied, 320 U.S. 748. Nothing in this case would warrant a departure from this general rule.

Thus, for example, there is no feature of the transferred White Motor shares that would justify valuing them at an amount in excess of the New York Stock Exchange price as of the date of the transaction. The transferred shares had no unique rights, powers or privileges. They were no different from the White Motor common stock traded on the stock exchange at a mean price of $36.3125 on the date petitioner's predecessor transferred the shares here at issue. In essence, the parties agreed to an exchange using stock as part of the consideration. If the value of that stock fell between the time the agreement was signed and the time it was executed, it is the latter date that controls for determining petitioner's cost basis in the assets it acquired, since it is the value of what it gave for the assets that constitutes its cost.

Nor did the stock transferred to Oliver have any other attributes justifying a higher valuation. There was no basis for a higher value on account of any control attributes because White Motor had insured that the voting power of the stock would be immediately dispersed by means of a pro rata distribution to the Oliver shareholders or a sale to the public in lots of not more than 10,000 shares to any one purchaser (Pet. App. 10a-12a). Indeed, the only evidence that the shares should not be valued at their stock exchange price indicated that they were worth less than that price. As all four of the expert witnesses testified (Pet. App. 30a), the block of shares transferred to Oliver was so large as to require a downward adjustment for blockage. Thus, the court of appeals correctly concluded that the stock exchange price for the stock had to be adjusted to reflect this blockage factor.

2. Contrary to petitioner's argument (Pet. 7-10), the decision below does not conflict with *Seas Shipping, Co.* v. *Commissioner,* 371 F.2d 528 (C.A. 2), certiorari denied, 387 U.S. 943. There, the court held that the value of Moore-McCormack stock that the taxpayer acquired in exchange for property was equal to the value of the property exchanged for that stock. The court so held even though the value of the assets less the other consideration yield a value for the Moore-McCormack stock which was in excess of the stock exchange market price on the date the transaction was consummated.

However, the evidence in that case showed that the taxpayer intended to hold the entire block of shares it acquired in order to exercise management powers over Moore-McCormack.[3] Accordingly, there was a factual basis for the conclusion that the taxpayer might have paid a premium price to acquire that degree of control.

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[3]As part of the transaction, the taxpayer received control of two directorships on the board of Moore-McCormack (see 371 F.2d at 530).

See, *e.g.*, *Perlman* v. *Feldmann*, 219 F.2d 173 (C.A. 2), certiorari denied, 349 U.S. 952.[4]

Furthermore, the value of the ships exchanged for the stock in *Seas Shipping* was supported by an independent finding of the Maritime Board that those assets were worth the amount assigned to it in the agreement and there was "ample and convincing" testimony (371 F.2d at 532) concerning the value of the transferred assets. Here, by contrast, there was no independent evidence in support of petitioner's $48.50 per share valuation or of the value of the Oliver farm equipment manufacturing business (see Pet. App. 23a-24a, n. 39).[5]

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[4]Moreover, as the court of appeals noted in *Seas Shipping* (371 F.2d at 530), there were doubts about the validity of the stock market price for the Moore-McCormack shares because the annual market of 166,000 shares was "too 'thin' to fix the value of a block of 300,000 shares" (371 F.2d at 530) (see Pet. App. 23a-24a, n. 39). Here, on the other hand, there was no basis for doubt about the correctness of the stock exchange price for the White Motor shares. The market price of the White Motor shares at the time the transaction was consummated should therefore prevail. See *Bankers Trust Co.* v. *United States*, 518 F.2d 1210, 1219-1223 (Ct. Cl.).

[5]Based upon contemporaneous sales of similar ships on the open market, the cargo ships exchanged in *Seas Shipping* for the Moore-McCormack shares were shown to be worth approximately $14,500,000. The consideration flowing from Moore-McCormack consisted of $5,466,668 in cash and notes and 300,000 shares of Moore-McCormack stock. Thus, the price paid by Moore-McCormack could only equal the value of the transferred ships if the Moore-McCormack shares were assigned a price of $30 per share (or $9,000,000 in the aggregate). (See 371 F.2d at 529). Here, however, as the court of appeals observed (Pet. App. 28a and n. 44), the value of Oliver's farm equipment business was never established. Accordingly, it was impossible to value the White Motor shares by reference to some established figure.

3. Finally, petitioner argues (Pet. 14-16) that the court of appeals erred in determining the blockage discount attributable to the transferred shares. However, the value of the White Motor shares determined by the court of appeals after application of this blockage discount coincided with the highest value placed upon that stock by any of the experts who testified as to blockage. The record does not support petitioner's claims of error with respect to blockage.

For the reasons stated, it is respectfully submitted that the petition for a writ of certiorari should be denied.

ROBERT H. BORK,
Solicitor General.

DECEMBER 1975.

DOJ-1975-12